No. 21816

In the

United States Court of Appeals

For the Ninth Circuit

United States of America, For the Use and Benefit of Chicago Bridge & Iron Company, an Illinois corporation,
Appellant,

vs.

Ets-Hokin Corporation, a California corporation, and The Travelers Indemnity Company, a Connecticut corporation,
Appellees.

On Appeal from the United States District Court
for the District of Arizona

Appellant's Reply Brief

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

No. 21,816

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I.

ARBITRATORS EXCEEDED THEIR POWERS UNDER 9 U.S.C. SECTION 10(d) WHERE THEY MISUSE PAROL EVIDENCE TO IMPOSE DUTY UPON APPELLANT TO PERFORM WORK NOT WITHIN SCOPE OF APPELLANT'S SUBCONTRACTUAL OBLIGATIONS.

A. Reasonableness of District Court's Interpretation of Arbitration Award.

An examination of the Opening and Answering Briefs on file herein leads Appellant to the conclusion that the principal issue for the Court in this Appeal is:

Was the District Court below in error when it concluded that the Arbitration Award should be affirmed, because it could be construed to have held that the work of prestressing was an implicit part of the work described in paragraph 1 (b) or any other part of the written subcontract dated August 22, 1962 taken severally or together? Appellees have stated in their Brief (p. 18):

". . . the Court (District Court) found (TR. p. 136, line 24, page 137, line 5), that a reasonable interpretation of the paragraphs 8, 11 and 12 of the majority opinion is that while there is no express covenant in the subcontract for CB&I to perform the prestressing work, it was understood and intended by the parties that the task of installation of the spiral cases included the prestressing work."

Appellant submits that any such finding by the Lower Court is not a reasonable interpretation of paragraph 8, regardless of whether it is read in conjunction with paragraph's 11 and 12 of the Arbitration Award, or by itself.

An oral offer to furnish a standby operator which was neither accepted nor refused in writing and as to which there was not one shred of testimony in the arbitration record that such offer was ever orally accepted by the Appellee Ets-Hokin,* was not adjudged by the arbitrators to be an obligation of the written subcontract. The arbitrators are not saying that because Appellant agreed to install the

*Appellees' have argued that it is incredible beyond belief to assert that Ets-Hokin rejected the oral offer (Transcript of Arbitration Hearings, Vol. II, page 319, line 1-5), yet the argument misses the point. Unless the offer could be shown to be a part of the written subcontract either expressly or by necessary implication, it was beyond the scope of the dispute submitted to arbitration, notwithstanding the Lower Court's apparent conclusion that the dispute was expanded beyond the issues raised by the written subcontract.

turbine spiral cases, it thereby also agreed to furnish a standby operator.

The arbitrators are merely saying that Appellant during the course of negotiations made an offer to furnish a standby operator, that the offer was made for the purpose of securing the subcontract, and that, therefore, Appellant should be bound by the offer. There is nothing ambiguous about paragraph 8 of the Arbitration Award, in or out of context; therefore, it is unreasonable and implausible for the Court to conclude that the Board had found the furnishing of a standby operator in connection with prestressing of the spiral cases during embedment to be one of the duties assumed by Appellant in agreeing to install the spiral cases under paragraph 1 (b) or any other provision of the written subcontract.

B. Misuse of Parol Evidence Is Not Merely Error in Interpretation of Law or Erroneous Finding of Fact.

Appellees' argue in their Answering Brief (p. 20) that even if the arbitrators violated the parol evidence rule, such violation is not a ground for vacation of the Arbitration Award. For purposes of this discussion, Appellant will concede that as a general proposition, an Arbitration Award will not be set aside for mere errors of law.

Be that as it may, the Federal Arbitration Act, 9 U.S.C. Section 10 (d) clearly gives to Appellant the right to have the Award set aside if in making it, the arbitrators have exceeded their powers. In the instant case, the violation of the parol evidence rule involves the arbitrators in exceeding their powers under the terms of the dispute submitted to them for decision. The arbitrators were asked to decide whether the subcontract agreement between the parties required the Appellant to perform the prestressing of the spiral cases as described in Bid Item 79 and Section 208 (g)

of the Completion Contract Specifications. They were not asked to decide the question of whether Appellants were liable for this work by reason of an oral offer made by Appellant during the course of negotiations in an effort to secure, or clinch, the subcontract.*

The existence of the oral offer came into evidence after the arbitrators had decided that they could reserve making any decision on the issue of whether the written subcontract was clear and unambiguous in its terms, as contended by Appellant, and take further evidence on the parol circumstances surrounding the subcontract (see general discussion Transcript of Arbitration Proceedings, pp. 12-27, and lines 4-9, p. 27). Thereafter, Appellees conducted extensive cross-examination of Appellant's witness concerning events and communications leading up to the award and execution of the subcontract in an effort to establish that prestressing was a part thereof. (Transcript of Arbitration Proceedings, pp. 27-72). Accordingly, on re-direct, Appellant's sales manager testified that, as an inducement to an award of the subcontract, he had in fact orally offered to furnish a stand-by operator in connection with the prestressing to Mr. Louis Bruni, the officer of Appellant, Ets-Hokin, who finally awarded the subcontract (Transcript of Arbitration Proceedings, pp. 82-86, lines 2 thru 17) and Mr. Bruni said nothing to the sales manager to indicate to the latter that he was accepting the offer, or making it a part of the subcontract agreement (Transcript of Arbitration Proceedings, p. 84, lines 18-26). Negotiations continued subsequent to the offer and the subcontract price underwent several revi-

*Appellees recognized this limitation upon the arbitrators when, at the Arbitration Hearing, they argued in favor of parol evidence on the ground that it was necessary to explain certain provisions of the subcontract agreement. (Transcript of Arbitration Proceedings P. 16-17).

sions from a price of $625,000.00 to a price of $592,000.00. It was this oral offer that the arbitrators deemed binding upon the Appellant. Paragraph No. 8 of the award refers specifically to this oral offer and not to any term or provision of the subcontract, nor does it draw its conclusion as a necessary implication from the written agreement.

By itself, the oral offer did not constitute an offer to perform the prestressing work. Contrary to Appellees' characterization on Page 17 of their Brief, there is more labor and expense to the prestressing work described in Section 208 (g) of the Completion Contract Specifications than the furnishing of a standby operator. Admittedly, the cost of a "standby operator", constituted the bulk of the cost of prestressing, but someone had to furnish the pump, the pipes, the valves and the gauges, and install and dismantle them. As the Arbitration Award itself recognized, certain costs backcharged by Ets-Hokin did not relate to the furnishing of a "standby operator" (e. g., Transcript of Record, p. 127, Item 17).

Additionally, as a description of the prestressing work demonstrates, (Paragraph 208 (g), Specifications, Exhibit B to Transcript of Arbitration Proceedings), it was inseparable from the cooling function which Appellee Ets-Hokin attempted to delegate ex post contracto to its concrete subcontractor (see Exhibits 26, 27, 28, 29 and Transcript of Arbitration Proceedings, p. 214, p. 212, line 25 to page 220, line 3), and this fact was recognized by the Arbitrators in making their award.* Accordingly, it is oversimplification to characterize prestressing as merely the furnishing of a "standby operator"; and this fact contributes to the isola-

*The Award splits the cost of the standby operator between Ets-Hokin and Chicago Bridge & Iron on the grounds that the standby operator was as necessary for the "cooling" as he was for the prestressing.

tion of the oral offer of a standby operator from the subcontract agreement itself, and the claim that the arbitrators found that prestressing was an implied covenant of the contract.

C. The Lower Court's Use of the Concepts of "Intent and Understanding" Serves Only to Confuse the Issue of Whether the Arbitrators Exceeded Their Powers.

The Lower Court in its opinion reasoned that the issues submitted to arbitration had been expanded by the Appellant when the latter argued to the Board the "intent and understanding" of the parties to the subcontract (Transcript of Record, p. 136, lines 1-18).

It was, and is, the intent and understanding of the parties as expressed and found in their written subcontract agreement which was at issue in this arbitration. The writing is supposed to express the agreement of the parties, to articulate the intent and understanding of the parties. Thus, it is normal for a person to speak of the written document in terms of the "intent and understanding" of the parties thereto as expressed therein.

The Arbitrators were thus asked: Was it the intent and understanding of the parties as expressed in the written subcontract that the Appellant perform the prestressing work required by the general contract? The Lower Court appears to be saying that by discussing the written subcontract in terms of its intent and understanding, the Appellant has expanded the scope of the arbitration to include the intent and understanding of the parties not only as expressed in or necessarily implied from the written subcontract, but their intent and understanding separate and apart from the subcontract agreement as it might be revealed by the events and communications prior to the execution of the

subcontract. This simply is just not so. At no time did the Appellant ask the arbitrators to ignore the written subcontract and make their own determination of the parties obligation over and above what can be drawn from the written agreement itself, either expressly or by necessary implication. Yes, this is what the Lower Court seems to imply:

> "Thus, both plaintiff and defendant included and understood to be included among the issues to be discussed and determined by the arbitrators the intention and understanding of the parties, which clearly goes beyond the question of the inclusion or not of a specific written covenant in the subcontract."
>
> (*Transcript of Record*) p. 136, lines 19-24).

If all the Lower Court means to say is that the parties intended for the arbitrators to construe or interpret the written subcontract, then Appellant has no argument with the Court, and would disagree with the Court only on the question of whether, in finding Appellant obligated to furnish a "standby operator", the arbitrators were construing or interpreting the written agreement. But, since the arbitrators obviously and unequivocably ignored the written agreement in rendering their decision that the Appellant should be bound to furnish a "standby operator", it is not reasonable for the Court to conclude that the arbitrators were construing or interpreting the written agreement.

Accordingly, the Court must be saying that the Appellant agreed to expand the issues beyond the "intent and understanding" of the parties as expressed in the written agreement to include an "intent and understanding" not based upon the written agreement, either expressly or by necessary implication, but upon events or circumstances occuring or existing prior to or contemporaneous with the execution of the agreement. Appellant agreed to no such thing, and, in this, claims the Court below to be in error.

D. The Parol Evidence Rule Demonstrates the Manner in Which the Arbitrators Exceeded Their Powers.

While Appellees deem the parol evidence rule to be a mere rule of law, for the violation of which, the Arbitration Award cannot be set aside, Appellant believes that its violation in this instance serves to point up the manner in which the arbitrators have exceeded their powers under 9 U.S.C. Section 10 (b).

To begin with, the rule has been well established that:

> "Neither a court of law nor a court of equity can interpolate in a contract what the contract does not contain, either in words or by necessary implication."
>
> 17 Am Jur 2d *Contracts,* Section 242, p. 629.

As demonstrated in the Opening Brief, the subcontract of August 22, 1962 was intended by the parties to set forth their entire agreement and transaction.

> "Generally speaking, where the parties to a contract intend a writing to be the sole memorial or integration of the contract, the writing embodies the contract and accordingly, the construction of the contract consists of the construction of the writing. . . ."
>
> "As a rule, all prior negotiations become embodied in the writing when both parties enter and sign a written contract. Thus, in the absence of mistake or fraud, a written contract merges all prior and contemporaneous negotiations in reference to the same subject and the whole engagement of the parties and the extent and manner of their undertaking are embraced in their writing. The written agreement, and not the correspondence which preceded it, is the correct exponent of the contract, and all verbal agreements made at or before are to be considered as merged in the written instrument."
>
> 17 Am Jur 2d *Contracts,* Section 260, pp. 662, 663.
>
> ". . . parol evidence is inadmissable to vary or contradict the terms of a valid, and plain and unambiguous

written contract, no preliminary negotiations, and no parol agreement prior to or contemporaneous with, a written contract, which tends to vary or contradict either its express provisions or its legal import, can be considered in construing it. . . . *Parol understandings, although they induce the making of a written contract are merged in the writing so that they cannot be used to change the contract or show any intent different from that expressed in the instrument.*" (Emphasis added)
17 Am Jur 2d *Contracts,* Section 261, pp. 664, 665.

Thus, Appellant's position throughout the arbitration hearing that the Board construe the subcontract from within its four corners and resort to extrinsic evidence only in the event it deems the subcontract unclear or ambiguous, is consistent with Appellant's contention that the issue of prestressing involved only the intent and understanding of the parties as expressed in the subcontract; and further, that in the event extrinsic evidence should be considered by the Board, it be done so only for the purpose of construing or interpreting the writing.* A reading of paragraph 8 of the Arbitration Award clearly shows that the Board did not consider the evidence of the prior oral offer to furnish a "standby operator" for the purpose of construing any provision of the subcontract or making any determination that

*In their Answering Brief (p. 20), Appellees argue that Apellant conceded to the Board that it could ignore the parol evidence rule, and presumably therefore consented to an expansion of the issues. Appellant's statements on page 15 of the Transcript of Arbitration Proceedings were not made with a view to expanding the issues, but in recognition of the fact that the arbitrators might not follow the guidelines of the rule and devise their own method for construing the written agreement. It was recognized that arbitrators are not bound to follow the technical rules of law and that they could utilize their own notions of justice in resolving the dispute; but, the dispute was not thereby expanded. It remained the same: namely, did the agreement of the parties as represented by the written subcontract require Chicago Bridge & Iron Company to do the prestressing?

prestressing was by implication from the terms, conditions and subject matter of the subcontract, a necessary part thereof. Paragraph 8 of the Award unequivocally states the proposition that the Appellant, having made the oral offer as an inducement to its grant, should be bound by the offer. One must assume at this point that the arbitrators must have found either an oral acceptance of the oral offer, (although the Hearing Record is devoid of such evidence) or a moral obligation to carry out the offer. In either case, the arbitrators are clearly making their Award on the basis of an issue not submitted to them for decision, i.e., whether Appellant should be obligated to perform the prestressing because of a prior oral offer made as inducement to secure the subcontract. Had that issue been within the scope of the submission, the Arbitrators would not have been exceeding their powers. As it was, that issue was not within the scope of Appellant's cause of action in the Arizona District Court, nor the Appellee's Demand for Arbitration, the Arizona District Court's Order staying the Court proceedings and the subsequent proceedings in arbitration. It was the Board's failure to stay within the limits prescribed by the parol evidence rule, of which it was fully advised, that led it astray and caused it to exceed its powers.

While Appellant does not subscribe to Appellees' criterion for determining when arbitrators exceed their powers, i.e., whether the arbitrators could reasonably believe that the binding effect of the prior oral offer was an issue for them to decide (see page 20, Answering Brief), nevertheless, it was Appellant's explicit explanations of the parol evidence rule which made it unreasonable for the arbitrators to believe that they were called upon to enforce an agreement or moral obligation, other than the written subcontract agreement.

II.

FAILURE OF APPELLANT TO PROTEST ARBITRATION TO ARBITRATORS DOES NOT WAIVE RIGHT OF APPELLANT TO PROTEST AWARD OF ARBITRATORS UPON STATUTORY GROUNDS.

On Page 12 of the Answering Brief, Appellees argue that because, subsequent to the Arizona District Court's Stay Order, Appellant proceeded to arbitrate without protest to the Arbitration Board and made no objections to the effect that the arbitrators were considering questions beyond the scope of the Stay Order, that they cannot now be heard to complain of an unfavorable Arbitration Award and allowed an opportunity to take another bite at the apple. Appellees cite *American Almond Products Co. v. Consolidated Pecan Sales Co.* 144 F.2d 448, 450 (2d Cir. 1944) in support of this proposition.

First, it should be noted that Appellant did protest the Arbitration in the most effective forum available to it at the time, the Arizona District Court. Appellant objected to arbitration primarily on the grounds that arbitrators would not adequately protect Appellants' Miller Act rights under its subcontract agreement; that questions of law and the interpretation of the legal obligations of the parties under a written subcontract agreement were at issue and that arbitration was not the proper means by which these rights and duties could be determined. Appellant was unable to convince the District Court Judge that its Miller Act rights would be prejudiced by the arbitration.

At that point, Appellant either had to proceed with arbitration, or appeal to this Court the Stay Order of the District Court. The decision was made to proceed with the arbitration in the hope that it would have a happy ending; but that if it did not, and the reasons therefor were the very reasons advanced by Appellant in support of its objections

to the Stay Order, it would be easier to demonstrate to an Appeal Court the prejudicial effects of arbitration upon Appellants' legal rights in the context of the rationale provided by the Supreme Court in *Wilko v. Swan,* 346 US 427 (1954) for its refusal to permit a party's legal rights under the Federal Securities Act of 1933 to be determined by arbitration.

Secondly, Appellants had no reason for anticipating in advance the fact that the arbitrators would base an allowance of the prestressing backcharges on an oral offer to provide a standby operator made during the course of contract negotiations.

Thirdly, the *American Almond Case,* Supra is not analogous to the facts at hand. In that case, a party against whom the arbitrators had assessed damages, objected to the Award on the ground that damages were not submitted to the arbitrators for decision and that in fixing the damages the arbitrators had considered evidence not in the record. (The record was actually devoid of evidence on the amount of damages, except for a statement of counsel as to market price). This, it was contended, constituted misbehavior by the arbitrators under 9 U.S.C. Section 10(c). It was conceded that the prevailing party's statement of issues contained a claim for damages. The complaining party being so advised, the Court found that the complainant was bound "in good faith either to protest that the prevailing party had misapprehended the scope of the submission, or to ask leave to put in evidence of market value."

> "The one course not open was to allow the arbitration to proceed to an award upon an assumption which (1) was naturally to be drawn from the submission itself, which (2) the plaintiff had plainly adopted, and which (3), so far as appears, demanded nothing of the arbitrators which they were not competent to provide."
>
> *American Almond Case,* Supra, p. 450.

Thus, while the *Almond* case does appear to impose a duty upon a party to an arbitration to protest an issue not agreed to by the party as an issue to be arbitrated, it was clear in that case that the claim for damages was a clean cut issue before the arbitrators. One of the parties had asked the arbitrators to make an award of damages. In the instant case, as can be seen from the Lower Court's attempt to include the oral offer as an issue in the arbitration, the issue was neither clean cut nor conceded by Appellant to be an issue in the arbitration. Indeed, Appellant's first awareness of it as an issue was the award of the arbitrators.

III.

9 U.S.C. 11(a) DOES NOT REQUIRE THAT THE MATERIAL MISCALCULATION REFERRED TO THEREIN APPEAR UPON THE FACE OF THE AWARD.

Appellees argue on page 21 of their Brief that the material miscalculation specified in 9 U.S.C. 11(a) as grounds for modifying or correcting an arbitration must appear upon the face of the Award. The two cases cited in support of this proposition do not appear to Appellant to stand for any such proposition. *James Richardson & Sons, Ltd. v. W. E. Hedger Transportation Corp.* 98 F.2d 55, 57 (2d Cir. 1938) involved a complaint on appeal to the effect that the arbitrators had failed to assess any damages for a carrier's delay in freighting wheat, although the arbitrators found delay and the freighting contract provided for damages for delay at a specified daily rate per ton. The Court said it would not amend the award or overrule the arbitrators on this point, because to do so would constitute disagreement as to matters of law or facts determined by the arbitrators.

In *San Martine Compania de Navegacion, S. A. v. Saguenay Terminals,* 293 F.2d 796 (9th Cir. 1961), the Court, hav-